

2006 Governor's Conference

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Invent the Future



PILOT Your Way to New Job Growth

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Taxation of Property

- Constitution
- The Tennessee Constitution sets forth several restrictions concerning the taxation of property, including:
 - Article 2, Section 28 of the Constitution provides that, "all property real, personal or mixed shall be subject to taxation."
 - Article 2, Section 29 of the Constitution permits the General Assembly to authorize the Counties and Towns to impose taxes, and requires that, "all property shall be taxed accordingly to its value."



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- Grant of Direct Tax Deferrals by Cities or Counties
 - The provision of Article 2, Section 28 of the Constitution, requiring that all property be subject to taxation, with certain limited exceptions, prohibits the creation of additional exemptions.
 - Consequently, the Cities and Counties in Tennessee may not grant tax deferrals to non-exempt persons.



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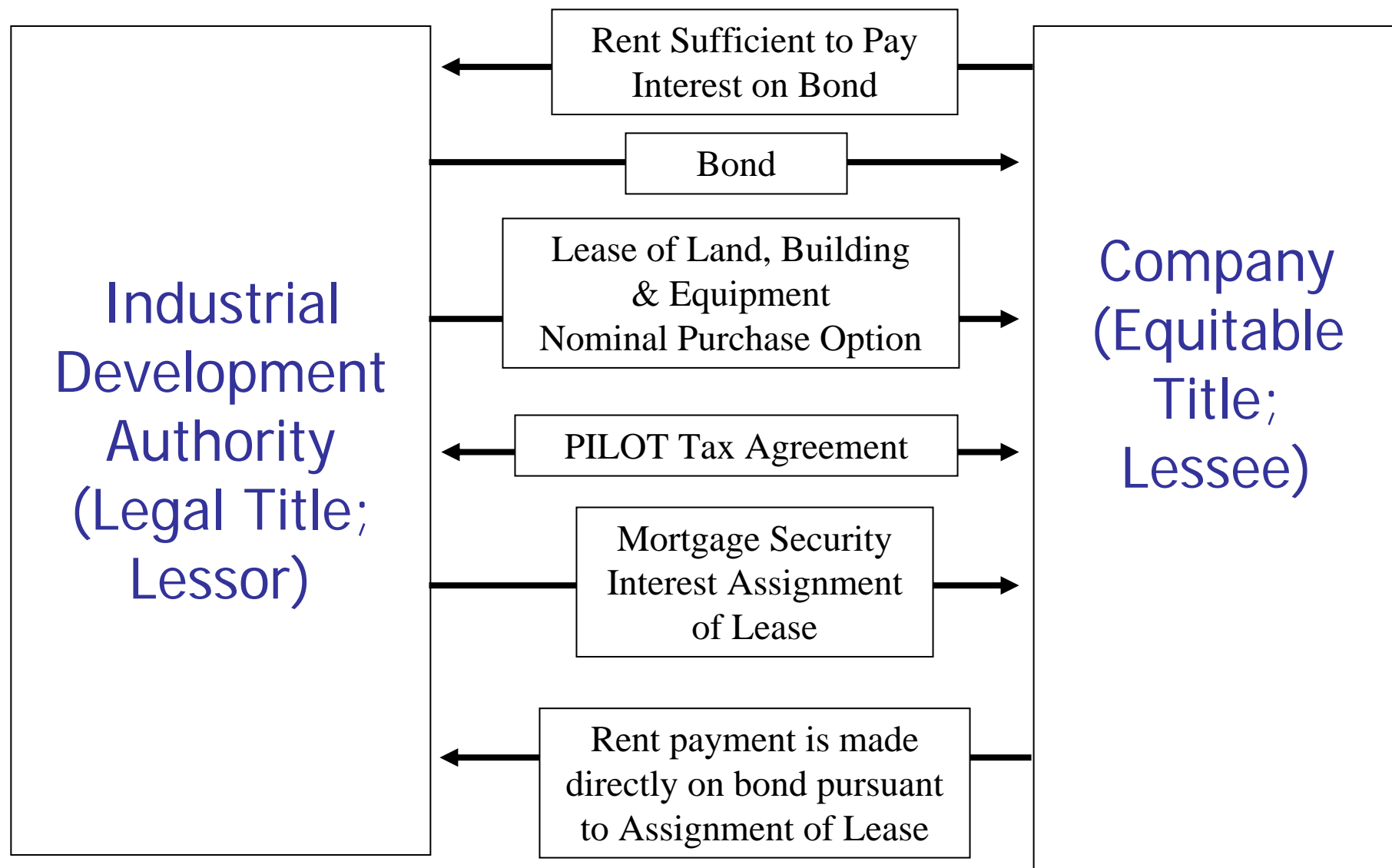
- Role of Industrial Development Corporations in Property Tax Abatements
 - Property owned by the Board is exempt from property tax; T.C.A. §7-53-305(a).
 - The Board may own and acquire property; T.C.A. § 7-53-302(a)(4).
 - The Board may lease property; T.C.A. § 7-53-302(a)(5).
 - The Board may issue bonds and notes; T.C.A. § 7-53-302(a)(9), 303.
 - The Board may enter into payment in lieu of tax agreements, if authority is delegated to it; T.C.A. § 7-53-305.



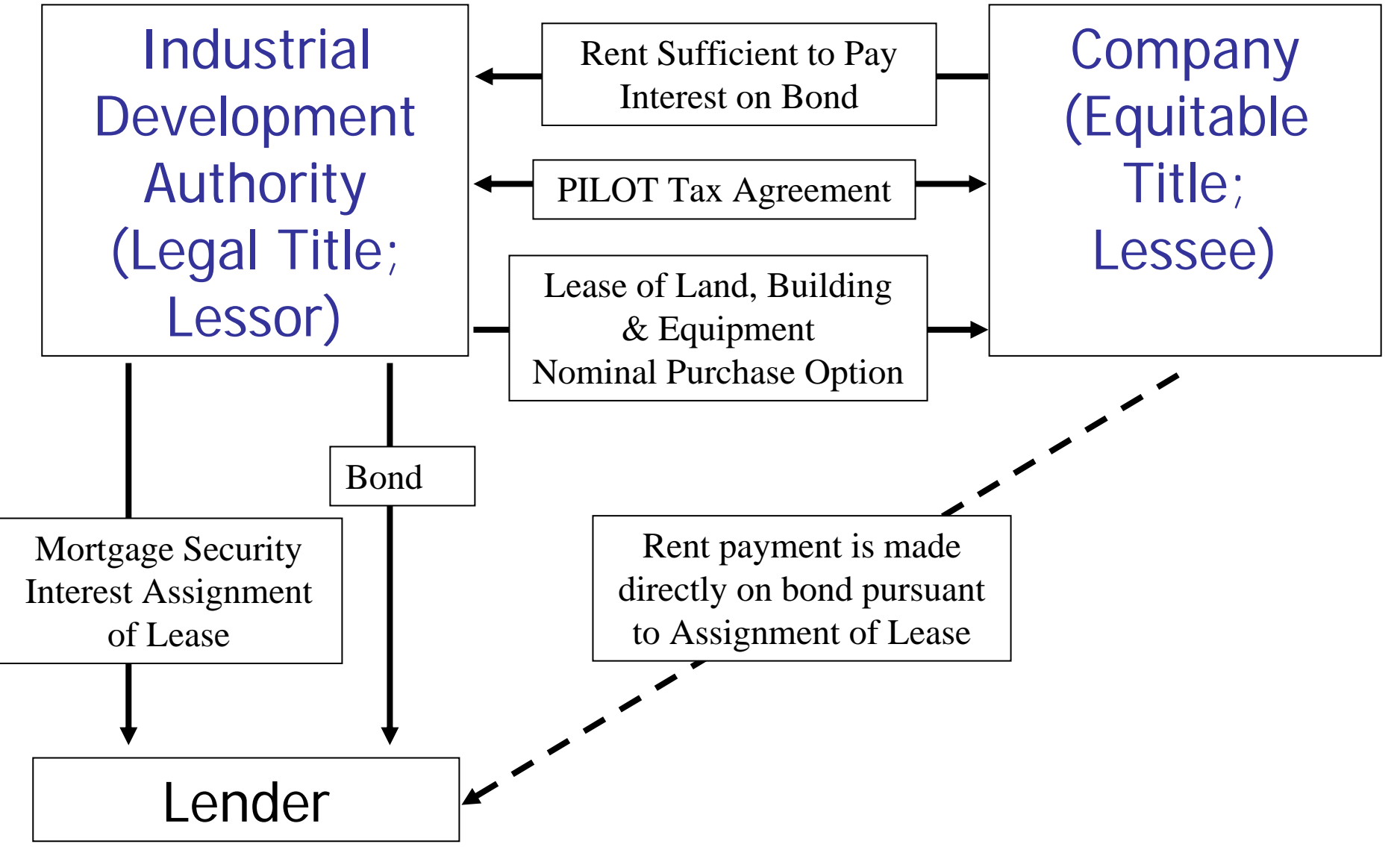
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- Constitutional Compliance
 - The Industrial Development Corporation Act does not violate the requirement in Article 2, Section 28 of the Constitution that all property be subject to taxation.
 - The Industrial Development Corporation Act does not violate the Article 2, Section 29 of the Constitution prohibition of the Cities or Counties from lending their credit "to or in aid or any person."

Basic IDB Sale Leaseback



Basic Lease Conduit IDB





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- Taxation of Real Property and Equipment
- Real Property
 - Real property owned by the Industrial Development Board is exempt from property tax. T.C.A. § 7-53-305.
 - Taxation of Leasehold Interests
 - When the fee owner of real property is exempt from tax, an interest in the property of the lessee is to be assessed to the lessee as real property. T.C.A. § 67-5-502(d).
 - The value of a leasehold is based on the excess of the fair market rent for the property over the actual and imputed rent payable under the lease for the property. T.C.A. § 67-5-605.



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- PILOT leases must be designed to minimize leasehold value.
 - Even if a lease is structured so that no leasehold value results, changing circumstances can result in a leasehold value over the term of the lease e.g.:
 - If the interest rate on the bonds is a variable rate, a positive leasehold value may result in years when the prevailing market interest rates are low resulting in corresponding low rent .
 - If the market rent increases, and the bond payments remain constant, a possible leasehold value may result.
 - It may be worthwhile to consider a catch-up provision in the PILOT agreement, giving the Company credit against its in lieu of tax payments for any sums paid on the value of its leasehold.



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Personal Property

- Taxation to Lessee
 - Leased personal property, even when owned by an Industrial Development Board, is classified according to the use of the property by the lessee and is taxed to the lessee, unless the property is subject to a "lawful agreement" between the lessee and a local government for payments in lieu of taxes. T.C.A. § 67-5-502(c).
 - Leasehold interests in personal property are not subject to property tax.
 - Leased personal property also is not assessed to the Industrial Development Board because the board is exempt from property tax.



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Summary

- Land
 - If the Industrial Development Board owns the land and improvements and leases the land and improvements to the Company, the land and improvements will not be subject to tax, although the Company's leasehold interest may be assessed if the lease is not properly structured.
- Equipment
 - If the Industrial Development Board owns the equipment and leases the equipment to the Company, the equipment will be exempt from tax if the Board and the Company enter into a payment in lieu of tax agreement.

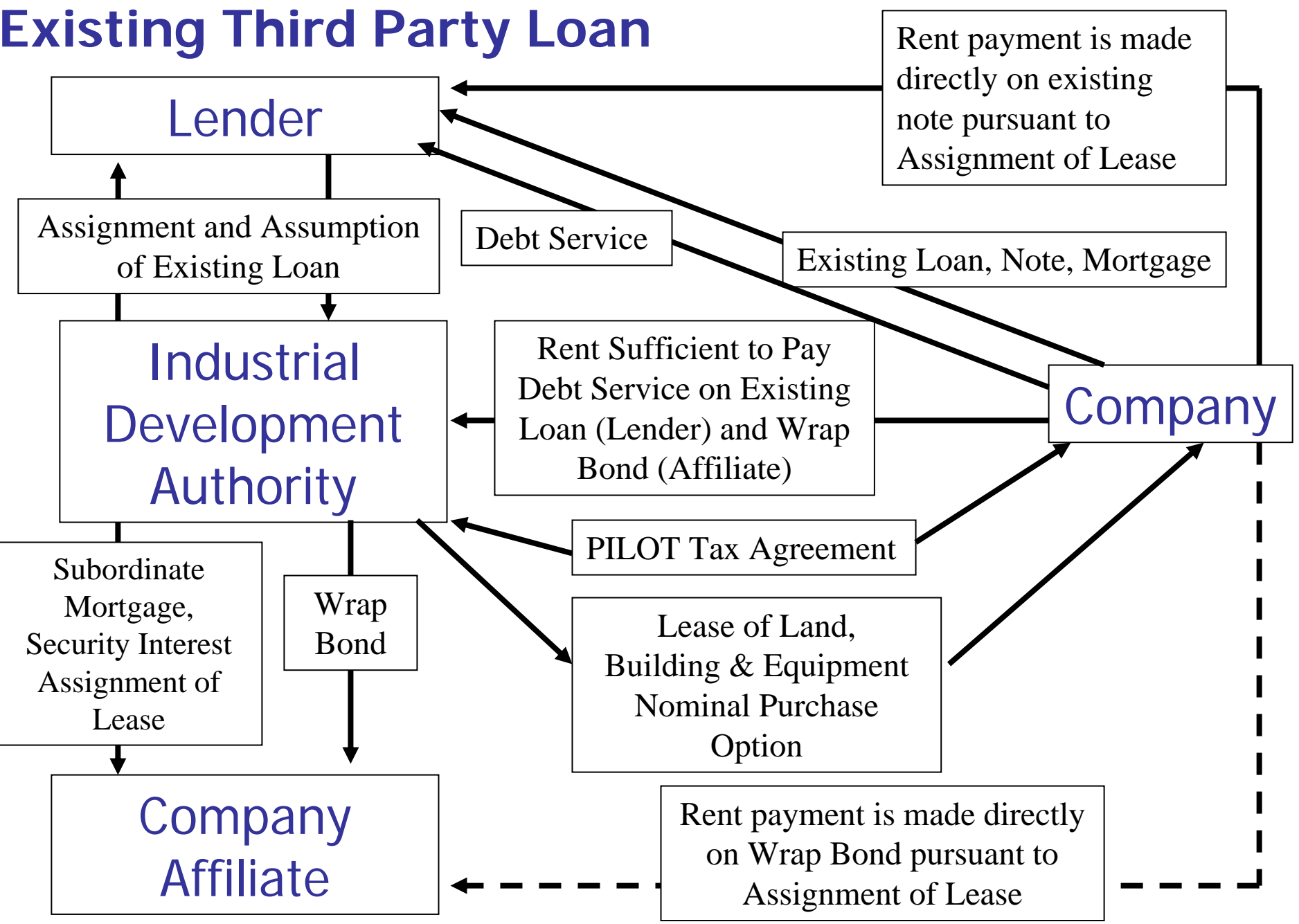


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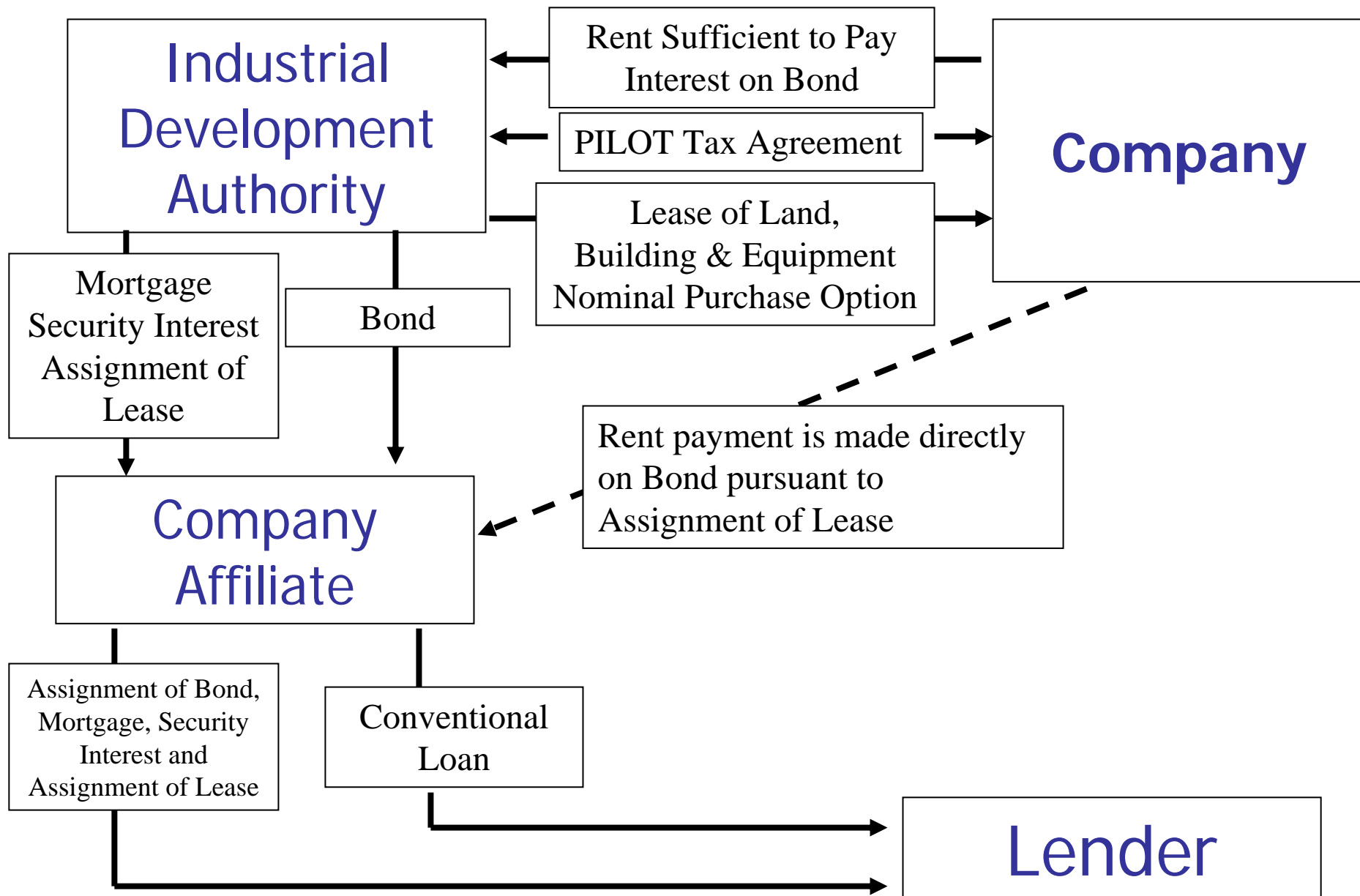
PILOT Complications

- Existing Secured Loan
- Sale of Company, Buyer's Lender Requires Security
- New Secured Loan
- Lender Requires Company Equity

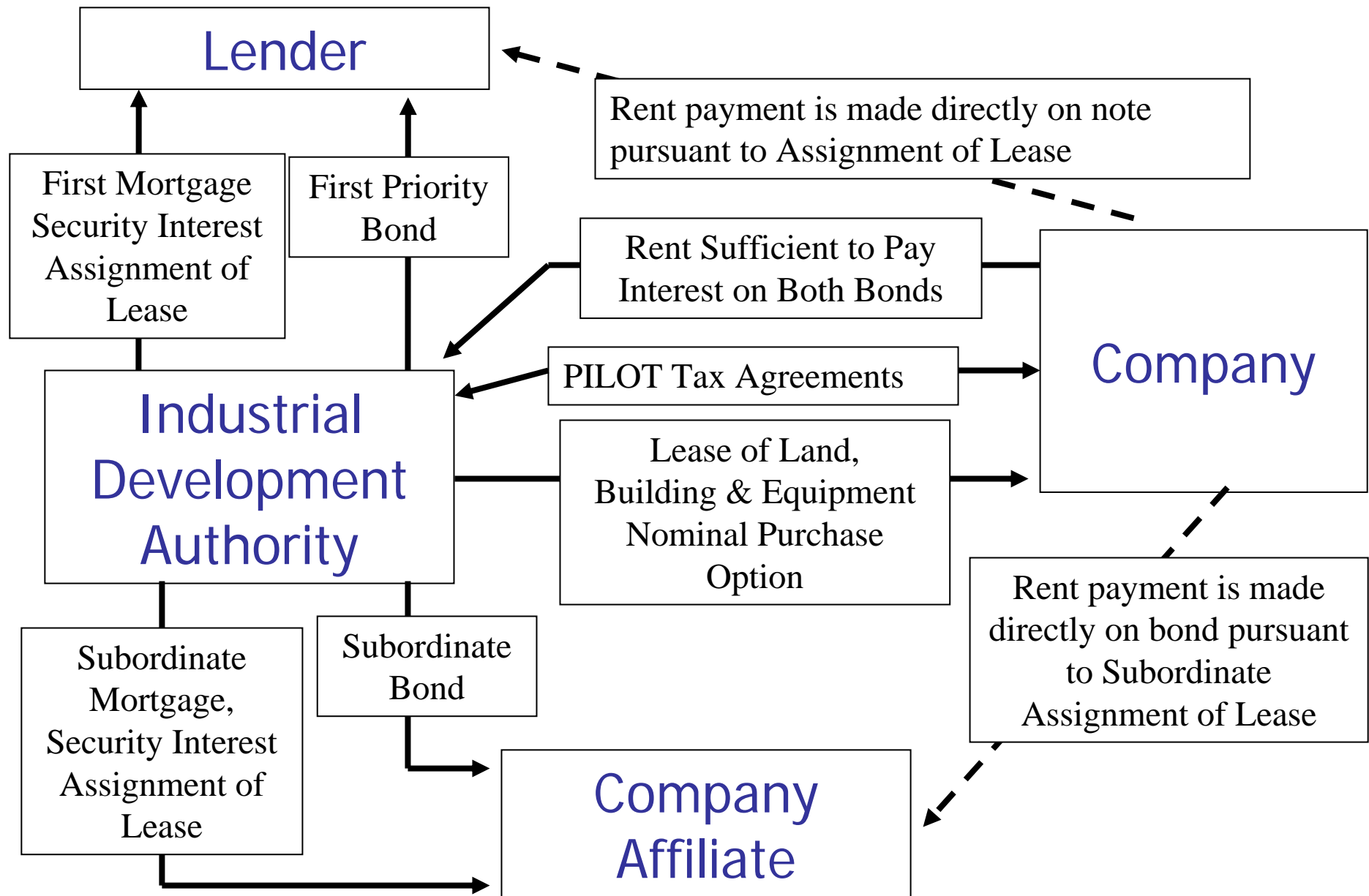
Existing Third Party Loan



Third Party Loan Outside of IDB; LBO



First Priority and Subordinate Equity Loans





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PILOT Complications

- **Expansion of Existing Building**
 - Subdivision Considerations
 - Separate Calculation of Abatement and PILOT
 - Separate tax parcel for addition
 - Create a formula based on valuation
 - Declining abatement adds complexity



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PILOT Complications

- **Equipment Issues**
 - Ramp-up and Equipment Purchases
 - Loss of CIP Benefits
 - Determination of Abatement Percentage
 - Transfer of Legal Title to IDB

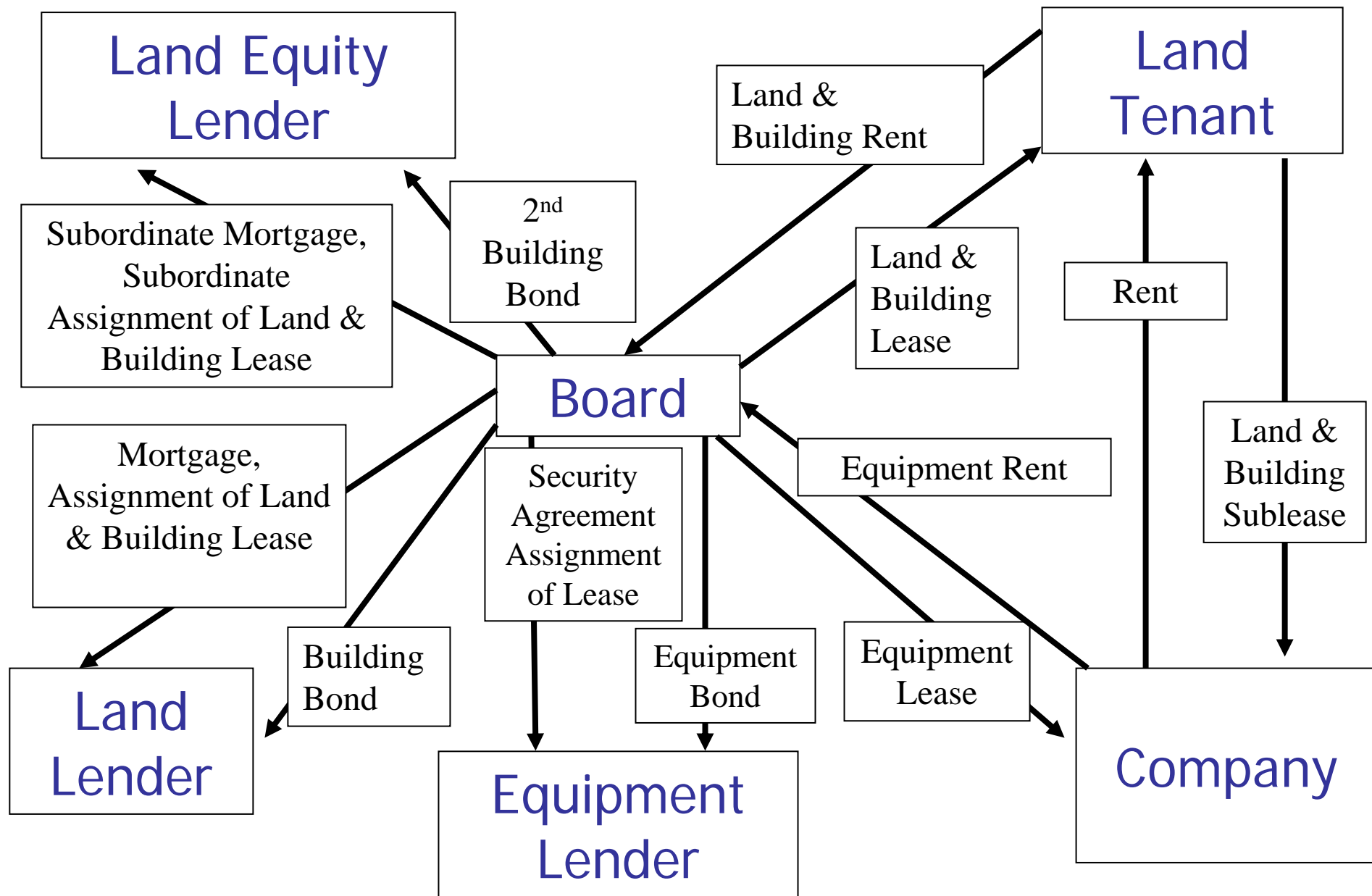


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PILOT Complications

- Developer-Owned Projects
- Equipment Financed by Equipment Leasing Company

Land & Equipment with Differing Lenders & Tenants





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PILOT Paperwork – Regulatory Compliance in the IDB Program

- Leasehold assessments
- Filing PILOT agreements
- Cost benefit analysis
- State's interest determination
- Annual report of lessees



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IDB Growing Pains

- Requiring city-county cooperation
- Preserving education levy
- Duration limits



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